

AGENDA
FREMONT PUBLIC FINANCING AUTHORITY MEETING
DECEMBER 7, 2010
7:00 P.M.

1. CALL TO ORDER

2. CONSENT CALENDAR

Items on the Consent Calendar are considered to be routine by the Public Financing Authority and will be enacted by one motion and one vote. There will be no separate discussion of these items unless an Authority Member or citizen so requests, in which event the item will be removed from the Consent Calendar and considered in its normal sequence on the agenda. Additionally, other items without a "Request to Address the Public Financing Authority" card in opposition may be added to the consent calendar. (In the report section of the agenda, consent items are indicated by an asterisk.)

2.1 *Approval of Minutes - for the Public Financing Authority Meetings of January 13, 2009 and June 9, 2009*

3. PUBLIC COMMUNICATIONS

3.1 Oral and Written Communications

4. PUBLIC HEARINGS – None.

5. OTHER BUSINESS

5.1 **PROPOSED ISSUANCE OF 2010 VARIABLE RATE DEMAND CERTIFICATES OF PARTICIPATION (COPs)**

Proposed Issuance of 2010 Variable Rate Demand Certificates of Participation (COPs) to Finance the Police Building Seismic Retrofit Project, Major Maintenance of Other City Buildings, Acquisition of Equipment, and Street Light Replacement with LEDs, and Appropriation of Funds (companion item on the City Council agenda)

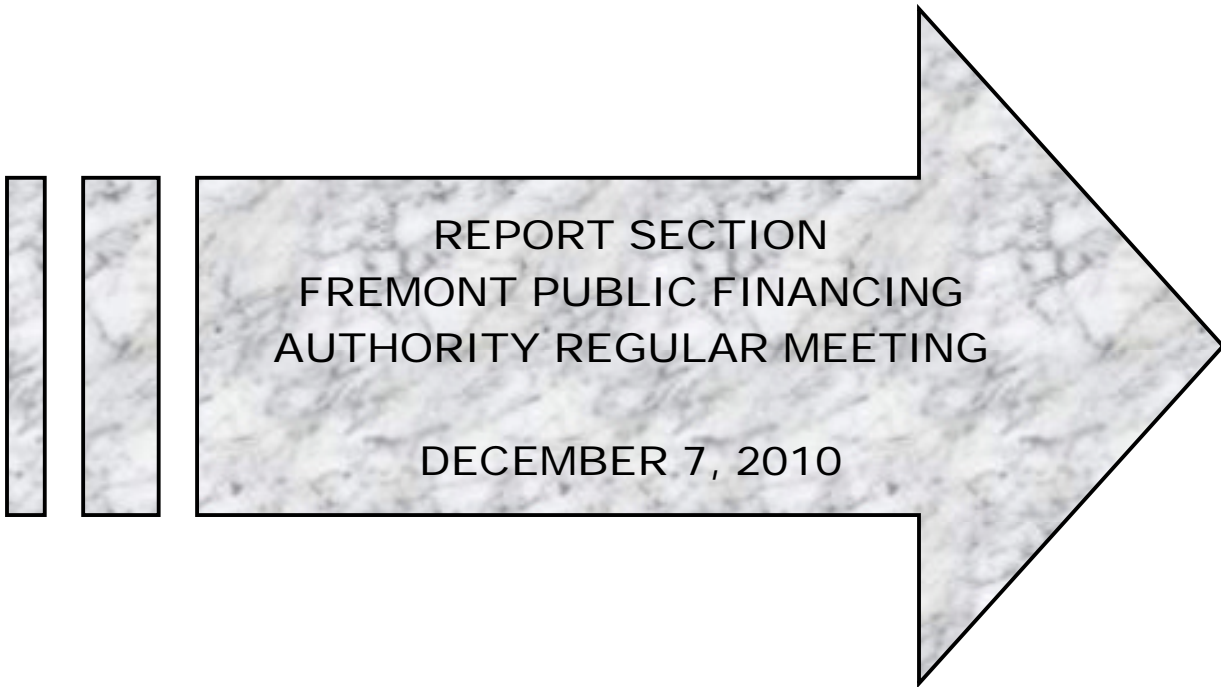
Contact Person:

Name: Harriet Commons
Title: Finance Director/Treasurer
Dept.: Finance
Phone: 510-284-4010
E-Mail: hcommons@fremont.gov

RECOMMENDATION:

1. Approve the issuance of the 2010 Variable Rate Demand Certificates of Participation with a principal amount not to exceed \$17,500,000, and approve and appropriate the use of debt proceeds for the capital projects described in the related City Council agenda report.
2. Adopt a resolution authorizing the preparation and execution by the officers identified in the resolution of all agreements, documents and certificates necessary to complete the 2010 Variable Rate Demand Certificates of Participation transaction, including the following lease financing documents (which are and have been on file with the Office of the Fremont City Clerk/PFA Secretary) in connection with the 2010 Variable Rate Demand Certificates of Participation:
 - a. Site and Facility Lease
 - b. Lease Agreement
 - c. Memorandum of Lease Agreement
 - d. Assignment Agreement
 - e. Trust Agreement with Union Bank of California
 - f. Certificate Purchase Agreement with Barclays Capital
 - g. Other administrative documents incidental to the transaction

6. ADJOURNMENT



5.1 PROPOSED ISSUANCE OF 2010 VARIABLE RATE DEMAND CERTIFICATES OF PARTICIPATION (COPs)

Proposed Issuance of 2010 Variable Rate Demand Certificates of Participation (COPs) to Finance the Police Building Seismic Retrofit Project, Major Maintenance of Other City Buildings, Acquisition of Equipment, and Street Light Replacement with LEDs, and Appropriation of Funds (companion item on the City Council agenda)

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Note: The companion report on tonight's agenda of the Fremont City Council is incorporated into the record here by this reference.

Executive Summary: In this report, staff proposes that the Authority Board approve the issuance of the 2010 Variable Rate Demand Certificates of Participation (COPs) and authorize execution of the associated lease financing documents. This financing will be undertaken in cooperation with the City of Fremont. The 2010 Variable Rate Demand COPs are proposed in an amount not to exceed \$17.5 million. This report explains the reasoning behind this proposed financing, the uses to be made of the debt proceeds, and the leasing of City properties to secure the debt service payments.

DISCUSSION/ANALYSIS: The proposed 2010 Variable Rate Demand COPs will provide \$17.5 million to fund all or a portion of the following capital projects: (1) Police Building seismic retrofit, (2) acquisition of public safety apparatus, (3) equipment for participation in the East Bay Regional Communications System Authority (EBRCSA) to enhance radio interoperability in Alameda and Contra Costa Counties, (4) major building and roof/HVAC renovations at the Development Services Center, Irvington Community Center, and the Main Library, and (5) streetlight replacement with LEDs.

The proposed COP issue will be in a principal amount not to exceed \$17.5 million. The principal amount is an upper limit that will not be exceeded, but which allows for the actual amount to be set depending on market interest rates available at the time of sale. This is a normal industry practice to avoid delaying the sale of the new debt to investors, and has been authorized by the City Council and PFA Board on previous occasions. The principal balance for the variable rate COPs is currently projected to be \$15.0 million.

The following table, using the latest scenario provided by the City's financial advisor, shows the estimated proceeds and uses for the 2010 COP issue:

Sources:

Total proceeds from sale of COPs	<u>\$15,000,000</u>
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Use of Proceeds:

Capital projects	\$14,738,714
Cost of issuance	172,705
Underwriter's discount	43,386
Letter of credit fee through February 1, 2011	20,195
Bank counsel	<u>25,000</u>

Total Uses of Proceeds	<u>\$15,000,000</u>
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The amount available for projects is slightly less than the estimated costs of the proposed projects. The portion of project costs not funded from proceeds of the COPs will be funded with City cash from other sources.

Interest Rates: The actual interest rate for the variable rate COPs will be reset each week (the rate for the first week is set on the sale date) by the underwriter (remarketing agent). The weekly reset interest rate is based on current market rates for short-term (one week) funds, and is set using the remarketing agent's best judgment as to the rate required to resell any COPs tendered by investors.

Each week, investors can tender (sell back) their COPs to the remarketing agent, who must purchase them. If the remarketing agent cannot resell tendered COPs, and does not want to hold them for its own account, then the standby purchase agreement bank must buy them. If the COPs still remain unsold for an extended time, the standby purchase bank can compel the City to retire the COPs with a cash payment. This remarketing process benefits the City by potentially keeping interest rates at the current lowest market traded levels available each week, but the process can put upward pressure on City interest rates if there is any deterioration in the third party credit ratings. No precise estimate of the actual interest rate over the term of the variable rate COPs can be made, but if history is an accurate guide, the realized interest rate on the variable rate COPs will be substantially less than for fixed interest rate COPs.

Lease Structure and Debt Service: The variable rate COPs will be issued under a lease/leaseback agreement between the City of Fremont and the PFA. Debt service will be paid by the PFA through the assignment of its lease (back) payments from the City to the trustee for the benefit of the COP investors. The City is entitled to use the proceeds from the COPs for its capital projects as consideration for the initial lease of its properties to the PRA. The COPs will mature in 28 years, on August 1, 2038. The variable rate issue can be called by the City at any time without a premium.

To enhance the marketability of the variable rate COPs, the City will pay a quarterly fee for a bank (U.S. Bank) to issue its direct pay letter of credit promising to both pay any debt service payments not made by the City, and to buy and hold any bonds tendered by any investors that cannot be resold by the underwriter. This credit enhancement contract will allow the City's 2010 Variable Rate Demand COPs to carry aaa/AAA credit ratings, thereby reducing their interest rates.

Lease/Leaseback Security: The City will lease various properties (listed below) to the PFA and then lease them back (so there will be no loss in City services or functionality). The PFA assigns the City lease payments to the trustee, who uses this money to pay investors. When the COPs are paid off, the leases expire and the properties revert to the City. Until then, the leased properties remain available for public operational use, but cannot be pledged (except on a subordinated basis) to secure other debts or City promises and cannot be sold without the substitution of adequate replacement security.

The lease/leaseback arrangements will involve the following properties:

- (1) Land and improvements located at 37299 Niles Boulevard (Fire Station 2);
- (2) Land and improvements located at 4355 Central Avenue (Fire Station 6);
- (3) Land and improvements located at 7200 Stevenson Boulevard (Fire Tactical Training Facility).

Risks Inherent in the Proposed Structure: The risks in a variable rate financing are as follows:

- Interest rate volatility – Interest rates may change daily, weekly or monthly based upon an index or a pricing standard stated in the debt contract. Estimates of interest costs are used for budgeting purposes, and may be lower or higher than the actual costs. Because the City's investment portfolio has a relatively short average maturity, the interest earned will generally move in the same direction as interest costs. There are also other safe financing products that can hedge interest rate risk.
- Remarketing risk – The investor has the right to sell the certificate/bond back to the issuer or remarketing agent at specified dates and for a specified price. There is a risk that the remarketing agent may not be able to resell the certificate/bond. This situation can happen when there is no market for this type of certificate/bond, such as in the case of a downgrade of the insurer.
- Ongoing administrative responsibility – Because of the fluctuation in interest rates, the debt service payment has to be recalculated on each payment date. Also, credit enhancements, such as letters of credit or standby purchase agreements, have shorter terms than do the COPs, which means that the agreements have to be renegotiated or terminated. If terminated, proposals to new providers have to be sent out and evaluated. Monitoring the credit rating of the credit enhancement provider is also necessary because, as the City has found, interest rates are sensitive to credit rating changes. Even though there is additional administrative work involved, staff believes the interest savings still outweigh the additional staff cost.

Credit Enhancement: By its nature, a variable rate demand COP requires a liquidity or credit enhancement provider to guarantee payment of debt service and to assure investors the funds are always available to purchase tendered certificates. The debt can be structured to use a letter of credit alone, or a combination of a standby purchase agreement and either bond insurance or a letter of credit. In either structure, an essential element of a variable rate financing is a remarketing agent who purchases and resells the tendered certificates.

- Letter of credit – The issuer enters into an agreement with a bank to provide security to the debt holders that moneys will be available to pay debt service on the due dates. It entitles the trustee to draw upon the letter of credit on every debt service payment date (direct pay) or the trustee draws

only when the moneys to pay debt service are insufficient (standby). The bank provides liquidity and credit enhancement, so the issue is marketed based on the bank's credit rating.

- Standby purchase agreement – This is an agreement with a financial institution that guarantees to buy the tendered certificates from the remarketing agent if the latter is unable to remarket the tendered certificates. The variable rate COPs have a demand feature, which gives the investor the option to tender the certificate at specified times prior to the stated maturity.
- Bond insurance – This is an insurance policy to guarantee payment of principal and interest on the due date by reason of non-payment by the issuer. Bond insurance companies insure the certificates during the life of the issue and provide a AAA rating to the certificates.

Given the dearth of bond insurers, staff has not pursued bond insurance for this issue. Proposals to provide a letter of credit/standby purchase agreement were sent out by the City's financial advisor. U.S. Bank, who recently provided the replacement letter of credit for the City's 2008 Variable Rate Demand COPs, will also provide the letter of credit for this issuance. Their letter of credit will be subject to renewal every three years at then prevailing rates. The current rate will be 1.00% of the covered amount annually plus a fee of \$250 per draw on the letter of credit (every quarterly payment date, generally). Rates for all credit enhancement products continue to be relatively high because of the global recession and the related credit market disruptions. If letter of credit renewal rates rise substantially, the City would be faced with the prospect of replacing the letter of credit bank. The City experienced this in 1999 when it replaced letter of credit banks in connection with the 1990 and 1991 COPs because of the high renewal rates then being charged by the initial letter of credit bank. The letter of credit bank (Allied Irish Bank) for the 2008 Variable Rate Demand COPs was replaced in October 2010 because of the financial turmoil in Ireland.

The City will continue to bear indirect credit risk and interest rate risk with the variable rate COPs. If the direct-pay letter of credit bank (U.S. Bank) encounters financial problems, the variable rate COPs could become unmarketable or marketable only at high rates. However, it is generally easier to substitute a letter of credit bank than to replace a bond insurer because there are more banks that write letters of credit than there are AAA-rated bond insurers.

There is no guarantee that interest rate levels as a whole will not rise substantially or that the average variable rates over the 28-year term of the COPs will be less than the fixed interest rate now available. History, and particularly the last twenty years of history, suggests that this scenario is unlikely. However, it is possible, and perhaps probable given the recent upheavals in the credit markets that led to the United States government making an unprecedented bail out of private markets, that interest rates (at least in the near term) are likely to be more volatile than the historical average would otherwise suggest.

City Long-term Debt Policy Compliance: Staff has analyzed future debt service payment scenarios in light of the City Council's adopted long-term debt policy. Using modest budget growth assumptions, the City will remain in compliance with Council's long-term debt policy after issuance of the 2010 Variable Rate Demand COPs.

The Financing Team: Staff proposes that the City engage the services of KNN Public Finance as financial advisor (contract amount not to exceed \$70,000 including expenses) and Quint and Thimmig

as bond counsel (contract amount not to exceed \$60,000 including expenses) for this issue. These charges will be paid from the COP sales proceeds.

Staff proposes that Union Bank of California serve as trustee, escrow agent, and fiscal agent with regard to the 2010 Variable Rate Demand COPs. The related annual operational costs will be paid annually during the life of the COPs and are not fixed in amount.

ENCLOSURES:

- [Resolution approving, authorizing and directing preparation and execution of certain lease financing documents in connection with the 2010 Variable Rate Demand Certificates of Participation](#)

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